



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

1100 Commerce Street

MS:4920:DAL

Dallas, TX 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

UIL: 501.03-01

Release Number: **200844020**

Release Date: 10/31/08

Legend

ORG = Organization name

ORG

ADDRESS

Date: June 5, 2008

XX = Date Address = address

Person to Contact / ID#:

Contact Telephone Number:

In Reply Refer to: TE/GE Review Staff

EIN:

LAST DATE FOR FILING A PETITION
WITH THE TAX COURT: September 4, 20XX

CERTIFIED MAIL

Dear ' '

This is a Final Adverse Determination Letter revoking the exempt status of ORG under section 501(a) as an organization described in section 501 (c)(3) of the Internal Revenue Code.

Our adverse determination was made for the following reasons:

A substantial part of your activities consists of providing down payment assistance to home buyers, regardless of the buyers' income level or need. To finance the assistance, you rely on home sellers and other real-estate related businesses that stand to benefit from these down payment assistance transactions. The payment from the home seller corresponds to the amount of the down payment assistance provided in substantially all of your down payment assistance transactions. The manner in which you operate demonstrates you are operated primarily to further your insiders' business interests. Therefore, you are operated for a substantial nonexempt purpose. In addition, your operations further the private interests of the persons that finance your activities. Accordingly, you are not operated exclusively for exempt purposes described in section 501 (c)(3). In addition, you have failed to meet the requirements of Internal Revenue Code section 501 (c)(3) and Treasury Regulation section 1.501 (c)(3)-1(d)(ii).

Based upon these reasons, we are revoking your exempt status under section 501 (a) as an organization described in IRC section 501(c)(3) effective October 1, 20XX.

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending September 30, 20XX, and for all years thereafter.

Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second St. N.W., Washington, D.C. 20217.

The last day for filing a petition for declaratory judgment is September 4, 20XX.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling or writing to:

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

Marsha A. Ramirez
Director, EO Examinations

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LEGEND

ORG = Organization name President = president XX = Date XYZ =
State City = city Address = address website = website CO-1 =
1st company

Issue:

Whether ORG operated exclusively for exempt purposes within meaning of section 501(c)(3)?

Facts:

ORG (hereinafter "ORG") is a XYZ not-for-profit corporation incorporated on May 20, 19XX. President is ORG's registered agent and President. ORG's address is Address, City, XYZ.

On December 05, 20XX, ORG applied for recognition as a tax-exempt organization under section 501(c)(3). On March 28, 20XX, based on the information that ORG provided in its application for exemption and on the assumption that ORG would operate in the manner represented in its application, ORG was recognized as a tax-exempt organization as described in section 501(c)(3).

Since 20XX, ORG has operated a down payment assistance (DPA) program by providing funds to home buyers for down payment or closing costs and collecting the same amount, plus additional fees, from the home sellers. ORG also advised that sellers may claim charitable deductions on their federal income tax returns for the amounts they paid to ORG. As more fully described below, ORG provided funds to anyone who qualified for a mortgage, whether first time homebuyers or not, without any income or asset limitations, and without ensuring homebuyer's affordability of the purchased home. ORG relied exclusively on the contributions from sellers to fund its remittances to homebuyers and charged market rate fees for its services, which essentially involved facilitation of real estate transactions. Since 20XX, the operation of the DPA program was the organization's primary activity.

Application for Recognition of Tax-Exempt Status:

Form 1023 was filed by ORG with the IRS to apply for recognition of tax-exempt status on December 5, 20XX. ORG submitted Schedule II-1 (Articles and Operational Information) with Form 1023 in which it outlines its two objectives. Objective Number One (Avoiding Exorbitant interest Rates and Predatory Lending) is explained as follows:

Generally, there are two reasons why individuals borrow money at exorbitant interest rates for the purchase of a home. First, they have a poor credit history and are unable to obtain financing through conventional lenders. Second, although they have a reasonable credit history, they are unable to save enough money to serve as a down payment because they are paying too much rent and other necessary expenses. The Project's goal primarily is to assist those individuals who fall into this second category and to provide some assistance to those who fall into the first category by reasons beyond their control.

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Traditional lenders, even those offering loans pursuant to FHA guidelines, generally require a down payment of at least three percent of the home's purchase price. Individuals who do not have sufficient reserves to make a down payment often seek to finance the entire purchase price of their homes. These types of loans generally offered only by finance companies whose loans feature extremely high interest rates that the borrower, either because of lack of education or because of a desperate desire to obtain safe, affordable housing, accepts. The high interest rate, in turn, causes the borrower to have to make payments each month that far exceed that which those who have a down payment must pay. This creates a situation in which the slightest, unexpected financial hardship causes the borrower to default on the loan, thus perpetuating a cycle of despair and financial hardship that reaches beyond individual calamity and destroys the communities that constitute our society.

This occurs primarily because the borrower made no down payment and has no equity in the home. As such, the borrower has to make higher payments each month, which prohibits the borrower from developing adequate savings. Also, when unexpected trouble arises, the borrower cannot refinance or obtain a home equity loan because no equity exists. It is the Project's intent to assist individuals in avoiding these harmful, and sometimes unlawful schemes.

The attachment also specifically describes the objectives of its Down Payment Assistance Program as follows:

The Project firmly believes that quality and affordable housing is essential to the development of strong communities and recognizes that the lack of funds sufficient to serve as a down payment inhibits community development. The Federal government, through various agencies including the Department of Housing and Urban Development, has expressly recognized these beliefs and has adopted numerous programs to assist America's citizens, including home loan programs through the Federal Housing Administration and the Veteran's Administration. To provide additional assistance, the Project has developed a program to make funds for down payments available to qualified participants, which shall primarily include low-income and very low-income individuals. The Project will give an amount sufficient to serve as a down payment to qualified participants. To be "qualified", a participant must otherwise qualify for an FHA, VA, or conventional loan. The Project will cause its activities to comply with the Internal Revenue Service Revenue Procedure 96-32, and the Project has signed a Declaration of Compliance with Revenue Procedure 96-32 which is attached hereto.

Regarding fundraising and contributions, the application states the following:

The Project will raise money for its programs by soliciting contributions from community organizations and charitable organizations, requesting contributions from individuals selling

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homes to participants in the Project's homebuyer assistance program, and conducting fundraising drives. The Project anticipates that many sellers may contribute to the Project's charitable purposes, but no seller will be required to contribute in order for a participant to receive down payment assistance.

Federal Returns:

ORG filed Forms 990 for fiscal years ended September 30, 20XX, 20XX, 20XX and 20XX; it did not file Forms 990-T. The return for the year under examination (fiscal year 20XX, ending September 30, 20XX) was filed on April 18, 20XX. ORG also filed Forms 941, W-2, and 1099-MISC.

In fiscal year 20XX, ORG's reported its activities as operation of DPA program as described in more detail below and making charitable contributions. On Form 990, Part III ORG reported 2 Program Service Accomplishments with their related expenses as follows:

- 1) Assist home buyers with down payments in order to purchase personal residence. (\$).
- 2) Charitable contributions to entities related to purpose of the ORG. (\$).

In fiscal year 20XX, ORG reported receiving \$ as gross revenue from amounts paid to it by sellers participating in ORG's DPA program. ORG reported the seller's payments as Direct Public Support. ORG also reported that it distributed \$ to homebuyers for use as down payment or closing costs. On Form 990, Part IV, line 73 ORG reported that as of September 30, 20XX, ORG had total unrestricted/net assets of (\$).

Operation of ORG's Down Payment Assistance Program:

ORG, through its website, flyers, and other methods, advertised its DPA program to builders, lenders, loan officers, mortgage brokers, real estate agents, buyers, and sellers. Many of the participants in ORG's DPA program utilize Federal Housing Administration (FHA) financing for their home purchase. To qualify for a federally insured mortgage, a buyer must make a down payment in a specified minimum amount, generally equal to 3% of the purchase price. To qualify under applicable Department of Housing and Urban Development (HUD) rules, such a buyer may only receive gifts to use for the down payment from a relative, employer, labor union, charitable organization, close friend, governmental agency, or public entity. The rules do not permit the seller to lend or give money to the buyer for the down payment.

Through ORG's DPA program, homebuyers receive a "gift" of the funds for the down payment or closing costs towards purchase of a participating home. During the year under examination, the down payment "gifts" were generally between 3% and 4% of the property's stated sales price. To enroll a house into the DPA program, ORG requires sellers to agree to pay to ORG an amount equal to the down payment "gift" that the buyer received under ORG's DPA program and an additional fee of \$ or 1% of the home's purchase price. The payment of "gift" and the fee are contingent upon the sale of a home through the ORG DPA program.

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ORG provides forms and instructions to be used for the DPA program. Its website contains the Participating Home Enrollment Form, which is completed by the seller and buyer (if known at the time). The form includes the following statement:

The seller agrees to contribute to The ORG an amount of \$ on the enrolled home mentioned above. For this, The ORG agrees to enroll the home in its Down Payment Assistance Gift Funds Program. The seller understands that this fee is not to be used as gift funds, closing costs, etc. on the purchase of this home and understands that the gift funds are derived from a pre-existing pool of funds from the ORG. The seller also understands that this fee is only due and payable if the enrolled home is purchased by a homebuyer who utilizes gift funds from The ORG. This donation is only due at the time of closing.

The buyer and seller must also complete and sign a Gift funds Availability Form. This form must be attached to the sales contract and includes the following statement:

Seller agrees to make a donation to The ORG in amount equal to the gift amount, which will be no more than 8% of the contract sales price on the subject property mentioned in the Purchase Agreement. The actual gift amount is ____% of the sales price. This amount is \$ _____. You are also agreeing to make a contribution to the Foundation in the amount of (\$). This amount is \$ _____. This amount is received by The ORG for assisting the buyer in identifying, pre-qualifying and educating the public on homeownership and is deposited into a Pool of Funds to be used to help others in the same manner.

Although the forms explicitly state that the down payment "gift" to a buyer comes from preexisting ORG funds or Pool of Funds, ORG does not have any such fund or endowment. ORG DPA program is funded exclusively on ongoing basis with the funds collected from the participating home sellers in the form of a mandatory "gift" that is equivalent to the amount granted to the homebuyer and a processing fee. Other than payments from sellers and related fees that are contingent upon the home's sale, ORG does not have any other source of funds and it carries out no fundraising activities. Thus, in fact the actual source of the down payment assistance is the seller's payment.

In essence, these transactions result in a circular flow of the money. The sellers make payments to ORG. ORG provides the funds to the buyers and in the process makes a profit from the fees it collects.

Despite the representations in its application for exemption, ORG does not have any income limitations for participation in its DPA program and it does not screen applicants for down payment assistance based on need, race, location of the home, or status as the first time homebuyer. The records provided by ORG do not give any indication that ORG screened applicants on these criteria. Rather, ORG's DPA program provided "gifts" to any homebuyers who qualified for a loan. Its Lender Guidelines posted on its website state, "No income, asset or citizenship requirements."

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ORG's Lender Guidelines indicate that anyone could qualify for ORG's down payment assistance program. For example, under the Borrower Eligibility Requirements (Section 4.1), the guidelines state the following:

"The ORG's main goal is to help first time homebuyers. However, families moving into larger homes due to family growth or improved financial situations where the gift can be used to keep from depleting savings and/or 401k are also a priority."

The guidelines specifically state in Section 4.4 (Household Annual Income Limitations) "There is no income limitation on this program."

In fiscal year 20XX ORG brokered approximately 82 DPA transactions. Most home sales were in the \$ to \$ price range.

ORG also encouraged participation in its DPA program by advising sellers may claim charitable deductions on their federal income tax returns for amounts they pay to ORG. On its website, and in other promotional materials, ORG characterized sellers' payments to ORG as "gifts," "donations," and "contributions". A flyer published and distributed by ORG stated "The Gift is tax deductible for the seller". ORG's Lender Guidelines also states "Gift fund and fee is tax deductible."

On its contract with each seller ORG also labeled the seller's payment to ORG as a "gift". These contracts obligate the seller, in consideration for participating in ORG's program, to pay ORG an amount equal to the amount of the DPA received by the buyer. The contract, which was required to be signed by each participating seller, states in part: "The seller also understands that this fee is only due and payable if the enrolled home is purchased by a homebuyer who utilizes gift funds from The ORG This donation is only due at the time of closing."

Law & Argument:

Section 501 of the Code provides for the exemption from federal income tax of corporations organized and operated exclusively for charitable or educational purposes, provided that no part of the net earnings of such corporations inures to the benefit of any private shareholder or individual. See I.R.C. § 501(c)(3).

Treasury Regulation section 1.501(c)(3)-1(c)(1) provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in section 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose. In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945), the Supreme Court held that the "presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."

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Treasury Regulation section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. To meet this requirement, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests.

Treasury Regulation section 1.501(c)(3)-1(d)(2) defines the term “charitable” for section 501(c)(3) purposes as including the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration. The term “charitable” also includes the advancement of education.

Treasury Regulation section 1.501(c)(3)-1(d)(3)(i) provides, in part, that the term “educational” for section 501(c)(3) purposes relates to the instruction of the public on subjects useful to the individual and beneficial to the community.

Treasury Regulation section 1.501(c)(3)-1(e) provides that an organization that operates a trade or business as a substantial part of its activities may meet the requirements of section 501(c)(3) if the trade or business furthers an exempt purpose, and if the organization’s primary purpose does not consist of carrying on an unrelated trade or business.

In Easter House v. United States, 12 Cl. Ct. 476, 486 (1987), aff’d, 846 F. 2d 78 (Fed. Cir. 1988) (unpublished table decision), the Court of Federal Claims considered whether an organization that provided prenatal care and other health-related services to pregnant women, including delivery room assistance, and placed children with adoptive parents qualified for exemption under section 501(c)(3). The court concluded that the organization did not qualify for exemption under section 501(c)(3) because its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court rejected the organization’s argument that the adoption services merely complemented the health-related services to unwed mothers and their children. Rather, the court found that the health-related services were merely incident to the organization’s operation of an adoption service, which, in and of itself, did not serve an exempt purpose.

The organization’s sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. In addition, although the organization provided health care to indigent pregnant women, it only did so when a family willing to adopt a woman’s child sponsored the care financially. Accordingly, the court found that the “business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff’s adoption service is its primary goal” and held that the organization was not operated exclusively for purposes described in § 501(c)(3). Easter House, 12 Cl. Ct. at 485-486.

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In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the court held that an organization that operated a school to train individuals for careers as political campaign professionals, but that could not establish that it operated on a nonpartisan basis, did not exclusively serve purposes described in section 501(c)(3) because it also served private interests more than incidentally. The court found that the organization was created and funded by persons affiliated with entities of a particular political party and that most of the organization's graduates worked in campaigns for the party's candidates. Consequently, the court concluded that the organization conducted its educational activities with the objective of benefiting the party's candidates and entities. Although the candidates and entities benefited were not organization "insiders," the court stated that the conferral of benefits on disinterested persons who are not members of a charitable class may cause an organization to serve a private interest within the meaning of Treasury Regulation section 1.501(c)(3)-1(d)(1)(ii). The court concluded by stating that even if the political party's candidates and entities did "comprise a charitable class, [the organization] would bear the burden of proving that its activities benefited members of the class in a non-select manner." American Campaign Academy, 92 T.C. at 1077.

In Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), the court held that an organization that marketed handicrafts made by disadvantaged artisans through museums and other non-profit organizations and shops operated for exclusively charitable purposes within the meaning of section 501(c)(3). The organization, in cooperation with national craft agencies, selected the handicrafts it would market from craft cooperatives in communities identified as disadvantaged based on objective evidence collected by the Bureau of Indian Affairs or other government agencies. The organization marketed only handicrafts it purchased in bulk from communities of craftsmen. The organization did not market the kind of products produced by studio craftsmen, nor did it market the handicrafts of artisans who were not disadvantaged. The court concluded that the overall purpose of the organization's activity was to benefit disadvantaged communities. The organization's commercial activity was not an end in itself but the means through which the organization pursued its charitable goals. The method the organization used to achieve its purpose did not cause it to serve primarily private interests because the disadvantaged artisans directly benefited by the activity constituted a charitable class and the organization showed no selectivity with regard to benefiting specific artisans. Therefore, the court held that the organization operated exclusively for exempt purposes described in section 501(c)(3).

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D. D.C. 2003), the court relied on the commerciality doctrine in applying the operational test. Because of the commercial manner in which the organization conducted its activities, the court found that it was operated for a nonexempt commercial purpose, rather than for a tax-exempt purpose. As the court stated:

Among the major factors courts have considered in assessing commerciality are competition with for-profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, inter alia, whether

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the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations.

See also, Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991) (holding that a religious organization which ran restaurants and health food stores in furtherance of its health ministry did not qualify for tax-exempt status because it was operated for substantial commercial purposes and not for exclusively exempt purposes).

Revenue Ruling 67-138, 1967-1 C.B. 129, held that helping low-income persons obtain adequate and affordable housing is a "charitable" activity because it relieves the poor and distressed or underprivileged. In Revenue Ruling 67-138, the organization carried on several activities directed to assisting low-income families obtain improved housing, including (1) conducting a training course on various aspects of homebuilding and homeownership, (2) coordinating and supervising joint construction projects, (3) purchasing building sites for resale at cost, and (4) lending aid in obtaining home construction loans.

Revenue Ruling 70-585, 1970-2 C.B. 115, discussed four situations of organizations providing housing and whether each qualified as charitable within the meaning of section 501(c)(3). Situation 1 described an organization formed to construct new homes and renovate existing homes for sale to low-income families who could not obtain financing through conventional channels. The organization also provided financial aid to low-income families who were eligible for loans under a Federal housing program but did not have the necessary down payment. The organization made rehabilitated homes available to families who could not qualify for any type of mortgage. When possible, the organization recovered the cost of the homes through very small periodic payments, but its operating funds were obtained from federal loans and contributions from the general public. The revenue ruling held that by providing homes for low-income families who otherwise could not afford them, the organization relieved the poor and distressed.

Situation 2 described an organization formed to ameliorate the housing needs of minority groups by building housing units for sale to persons of low and moderate income on an open-occupancy basis. The housing was made available to members of minority groups who were unable to obtain adequate housing because of local discrimination. The housing units were located to help reduce racial and ethnic imbalances in the community. As the activities were designed to eliminate prejudice and discrimination and to lessen neighborhood tensions, the revenue ruling held that the organization was engaged in charitable activities within the meaning of section 501(c)(3).

Situation 3 described an organization formed to formulate plans for the renewal and rehabilitation of a particular area in a city as a residential community. The median income level in the area was lower than in other sections of the city and the housing in the area generally was old and badly deteriorated. The organization developed an overall plan for the rehabilitation of the area, sponsored a renewal project, and involved residents in the area renewal plan. The organization also purchased an apartment building that it rehabilitated and rented at cost to low and moderate income

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families with a preference given to residents of the area. The revenue ruling held that the organization was described in section 501(c)(3) because its purposes and activities combated community deterioration.

Situation 4 described an organization formed to alleviate a shortage of housing for moderate-income families in a particular community. The organization planned to build housing to be rented at cost to moderate-income families. The revenue ruling held that the organization failed to qualify for exemption under section 501(c)(3) because the organization's program was not designed to provide relief to the poor or further any other charitable purpose within the meaning of section 501(c)(3) and the regulations.

Revenue Ruling. 2006-27, 2006-21 C.B. 915, in part, discusses whether down payment assistance organizations described in 3 situations operate exclusively for charitable purposes. Those described in Situations 1 and 2 are relevant to this discussion. The organization described in Situation 1 makes assistance available to low-income families to purchase decent and safe homes throughout the metropolitan area in which it is located. Individuals are eligible to participate if they are low-income and have the employment history and financial history to qualify for a mortgage with the exception that they do not have the funds necessary for down payments.

The organization in Situation 1 offers financial seminars, conducts educational activities to prepare the individuals for home ownership, and requires a home inspection report before providing funds for down payment assistance. To fund the program, the organization conducts broad based fundraising that attracts gifts, grants, and contributions from the general public. Further, the organization has policies in place to ensure that the grantmaking staff does not know the identity or contributor status of the home seller or other parties who may benefit from the sale and does not accept contributions contingent on the sale of particular properties.

Because the organization described in Situation 1 relieves the poor and distressed, requires a home inspection to ensure that the house is habitable, conducts educational seminars, has a broad based funding program, and has policies to ensure that the organization is not beholden to particular donors, the Service held that the organization is operated exclusively for charitable purposes and qualifies for exemption from federal taxation as an organization described in section 501(c)(3).

The organization described in Situation 2 of Revenue Ruling 2006-27 is like that described in Situation 1 except that (1) its staff knows the identity of the party selling the home and may know the identity of other parties involved in the sale; (2) the organization receives a payment from the seller (the amount of which bears a direct correlation to the amount of down payment assistance provided) in substantially all the cases in which the organization provides assistance to the home buyers; and (3) most of its financial support comes from home sellers and related businesses that may benefit from the sale of homes to buyers who receive assistance from the organization.

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Because the organization described in Situation 2 provides down payment assistance amounts that directly correlate to the amounts provided by home sellers and relies primarily on payments from home sellers and real estate related businesses that stand to benefit from the transactions to finance the program, the Service held that the organization described in Situation 2 is not operated exclusively for exempt purposes and does not qualify for exemption from federal income tax as an organization described in section 501(c)(3).

Benefiting Private Interests:

Even if an organization's activities serve a charitable class or are otherwise charitable within the meaning of section 501(c)(3), it must demonstrate that its activities serve a public rather than a private interest within the meaning of Treasury Regulation section 1.501(c)(3)-1(d)(1).

Revenue Ruling 72-147, 1972-1 C.B. 147, held that an organization that provided housing to low income families did not qualify for exemption under section 501(c)(3) because it gave preference to employees of a business operated by the individual who also controlled the organization. The ruling reasoned that, although providing housing for low-income families furthers charitable purposes, doing so in a manner that gives preference to employees of the founder's business primarily serves the private interest of the founder rather than a public interest.

In KJ's Fund Raisers v. Commissioner, T.C. Memo 1997-424 (1997), aff'd, 166 F.3d 1200 (2d Cir. 1998), the Tax Court held, and the Second Circuit affirmed, that an organization formed to raise funds for distribution to charitable causes did not qualify for exemption under section 501(c)(3) because its activities resulted in a substantial private benefit to its founders. The founders of the organization were the sole owners of KJ's Place, a lounge at which alcoholic beverages were served. The founders served as officers of the organization and, at times, also controlled the organization's board. The Tax Court found, and the Second Circuit agreed, that the founders exercised substantial influence over the affairs of the organization. The organization's business consisted of selling "Lucky 7" or similar instant win lottery tickets to patrons of KJ's Place. The organization derived most of its funds from its lottery ticket sales. The organization solicited no public donations. The lottery tickets were sold during regular business hours by the owners of the lounge and their employees. From the proceeds of the sales of the lottery tickets, the organization made grants to a variety of charitable organizations. Although supporting charitable organizations may be a charitable activity, the Tax Court nevertheless upheld the Commissioner's denial of exemption to the organization on the ground that the organization's operation resulted in more than incidental private benefit. The Tax Court held, and the Second Circuit affirmed, that a substantial purpose of KJ's activities was to benefit KJ's place and its owners by attracting new patrons, by way of lottery ticket sales, to KJ's Place, and by discouraging existing customers from abandoning KJ's Place in favor of other lounges where such tickets were available. Thus, the organization was not operated exclusively for exempt purposes within the meaning of section 501(c)(3).

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Promoting Improper Charitable Contribution Deductions:

Section 170(a)(1) of the Code allows as a deduction, subject to certain limitations and restrictions, any charitable contribution (as defined in section 170(c)), payment of which is made within the taxable year.

Section 170(c) of the Code defines a charitable contribution as a contribution or gift to or for the use of an entity described in one of the paragraphs of section 170(c). Section 170(c)(2) describes certain entities organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.

Generally, to be deductible as a charitable contribution under section 170 of the Code, a transfer to a charitable organization must be a contribution or gift. A charitable contribution is a transfer of money or property without receipt of adequate consideration, made with charitable intent. United States v. American Bar Endowment, 477 U.S. 105, 117-18 (1986). A payment generally cannot be a charitable contribution if the payor expects a substantial benefit in return. American Bar Endowment at 116-117; see also Singer Co. v. United States, 449 F. 2d 413, 423 (Ct. Cl. 1971). Substantial benefits are those that are greater than those that inure to the general public from transfers for charitable purposes (which benefits are merely incidental to the transfer). Singer at 423.

Section 102 of the Code provides that the value of property acquired by gift is excluded from gross income. A gift "proceeds from a 'detached and disinterested generosity,' ... 'out of affection, respect, admiration, charity or like impulses.'" Commissioner v. Duberstein, 363 U.S. 278, 285 (1960). Payments that proceed from "the constraining force of any moral or legal duty," or from "the incentive of anticipated benefit" of an economic nature," are not gifts. Duberstein, 363 U.S. at 285. Thus, payments attendant to ordinary business or commercial transactions, or that proceed primarily from the moral or legal obligations attendant to such transactions, are not gifts.

Organizations that promote tax avoidance schemes do not qualify for exemption under section 501(a) as organizations described in section 501(c)(3). See Church of World Peace, Inc. v. Commissioner, T.C. Memo 1994-87 (1994), aff'd, 1995 U.S. App. LEXIS 8775 (10th Cir. 1995). In Church of World Peace the church used its tax-exempt status to create a circular tax-avoidance scheme. Individuals made tax-deductible charitable donations to the church. The church then returned the money to the individuals in the form of tax-free "housing allowances" and also reimbursed the individuals for "church expenses" that were in fact unrelated to church operations. The Church emphasized tax advice in connection with this tax-avoidance scheme. The Tax Court held, and the Tenth Circuit affirmed, that the church did not comply with the requirements of § 501(c)(3) because, by promoting a circular flow of funds from donors to the church and back to the donors and facilitating improper charitable contribution deductions, the church did not operate exclusively for exempt purposes enumerated in § 501(c)(3).

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Effective date of revocation:

An organization may ordinarily rely on a favorable determination letter received from the Internal Revenue Service. Treas. Reg. §1.501(a)-1(a)(2); Rev. Proc. 2003-4, 2003-1 C.B. 123, §14.01 (cross-referencing §13.01 et seq.). An organization may not rely on a favorable determination letter, however, if the organization omitted or misstated a material fact in its application or in supporting documents. In addition, an organization may not rely on a favorable determination if there is a material change, inconsistent with exemption, in the organization's character, purposes, or methods of operation after the determination letter is issued. Treas. Reg. § 601.201(n)(3)(ii); Rev. Proc. 90-27, 1990-1 C.B. 514, §13.02.

The Commissioner may revoke a favorable determination letter for good cause. Treas. Reg. § 1.501(a)-1(a)(2). Revocation of a determination letter may be retroactive if the organization omitted or misstated a material fact or operated in a manner materially different from that originally represented. Treas. Reg. § 601.201(n)(6)(i), § 14.01; Rev. Proc. 2003-4, § 14.01 (cross-referencing § 13.01 et seq.).

Analysis:

ORG does not operate exclusively for exempt purposes as an organization described in section 501(c)(3) because it operates a program that (1) does not exclusively serve an exempt purpose described in section 501(c)(3), (2) provides substantial private benefit to persons who do not belong to a charitable class, and (3) is an unrelated trade or business designed to maximize profits and other commercial purposes.

Charitable purposes include relief of the poor and distressed. See Treas. Reg. § 1.501(c)(3)-1(d)(2) of the regulations. ORG does not operate its DPA program in a manner that primary addresses the needs of low-income people by enabling low-income individuals and families to obtain decent, safe housing. See Rev. Rul. 70-585, Situation 1. The down payment assistance program did not serve exclusively low-income persons. ORG did not screen applicants for down payment assistance based on income. ORG's records do not include data on the buyers' incomes. Instead, the program is open to anyone, without any income limitations, who otherwise qualifies for a mortgage.

Despite the representations in its application for exemption, in fact, ORG does not have any limitations for participation in its DPA program. ORG DPA program is not limited to the first time homebuyers and it is not limited to certain geographic areas or target those areas experiencing deterioration or neighborhood tensions. See Rev. Rul. 70-585, Situation 4. Arranging or facilitating the purchase of homes in a broadly defined geographic area does not combat community deterioration or serve other social welfare objectives within the meaning of section 501(c)(3) of the Code.

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Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279, 283 (1945), the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. Even if ORG DPA program was directed to exclusively low-income individuals or disadvantaged communities, ORG's total reliance for financing of its DPA activities on home sellers demonstrates that, like the organization described in Situation 2 of Rev. Rul. 2006-27, and in Easter House, ORG DPA program is operated for the substantial purpose of benefiting private parties who fund its operations.

Like the organization considered in American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), ORG is structured and operated to assist the private parties who fund it and give it business. Sellers who participate in ORG's DPA program benefit from achieving access to a wider pool of buyers, thereby decreasing their risk and the length of time the home is on the market. They also benefit by being able to sell their home at the home's full listed price or by being able to reduce the amount of the negotiated discount on their homes. Buyers who participate in ORG's DPA program benefit by being able to purchase a home without having to commit more of their own funds. Real estate professionals who participate in ORG's DPA program, from real estate brokers to escrow companies, benefit from increased sales volume and the attendant increase in their compensation. It is evident from the foregoing that ORG's DPA program provides substantial private benefit to the various parties in each home sale transaction, including homebuyers, house sellers, homebuilders, real estate and mortgage professionals.

The manner in which ORG operated its DPA program shows that the private benefit to the various participants in ORG's activities was the intended outcome of ORG's operations rather than a mere incident of such operations. To finance its down payment assistance activities, ORG relies exclusively on sellers and other real-estate related businesses that stand to benefit from the transactions it facilitates.

Like the organization described in Situation 2 of Revenue Ruling 2006-27, ORG neither solicits nor receives funds from other sources. Before providing down payment assistance, ORG's staff takes into account whether there is a home seller willing to make a payment to cover the down payment assistance the applicant has requested. ORG requires the home seller to reimburse it, dollar-for-dollar (plus an administrative fee of several hundred dollars per home sale) for the amount of funds expended to provide down payment assistance on the seller's home. ORG secures an agreement from the seller stipulating to this arrangement prior to the closing. No DPA assistance transactions take place unless ORG is assured that the amount of the down payment plus the fee is paid or will be paid by the seller upon closing. ORG's instructions to title and escrow companies provide that at the close of escrow the seller's payment, along with any ORG fees, must be sent to ORG within 24 hours. ORG's receipt of a payment from the home seller corresponding to the amount of the down payment assistance in virtually every transaction indicates that the benefit to the home seller (and others involved in the transaction) is

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not a mere accident but rather an intended outcome of ORG's operations. In this respect, ORG is like the organization considered in Easter House which provided health care to indigent pregnant women only when a family willing to adopt a woman's child sponsored the care financially.

ORG's promotional materials show that ORG operated in a manner consistent with a commercial firm seeking to maximize sales of services, rather than in a manner that would be consistent with a charitable or educational organization seeking to serve one or more of the charitable purposes enumerated in section 501(c)(3). The manner in which ORG operated its DPA program shows that ORG was in the business of facilitating the sales of homes in a manner indistinguishable from an ordinary trade or business. In this respect ORG's operations were similar to an organization which was denied exemption because it operated a conference center for commercial purposes. See Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003). ORG relied exclusively on contributions from sellers, all of which were mandatory and contingent upon the sale of the sellers' home. Similarly to an ordinary trade or business in the business of facilitating real estate transactions, ORG charged a market rate transaction fee.

Operating a trade or business of facilitating home sales is not an inherently charitable activity. Unlike the trade or business in Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), ORG's trade or business was not utilized as a mere instrument of furthering charitable purposes but was an end in itself. ORG provided services to home sellers for which it charged a market rate fee. ORG did not target persons within a charitable class. ORG's primary goal consisted of maximizing the fees it derived from facilitating the sales of real property. ORG did not solicit or receive any funds from parties that did not have interest in the down payment transactions. Like the organizations considered in American Campaign Academy, *supra*, and Easter House v. United States, 12 Cl. Ct. 476, 486 (1987), *aff'd*, 846 F. 2d 78 (Fed. Cir.) a substantial part of ORG's activities furthered commercial rather than exempt purposes.

ORG is also not entitled to exemption under section 501(c)(3) because it encouraged improper charitable contribution deductions. A payment of money generally cannot be deducted as a charitable contribution if the payer expects to receive a substantial benefit in return. A seller's payment to ORG is not tax deductible as a charitable contribution under section 170 because the seller receives valuable consideration in return for the payment. In addition, the seller's payment to ORG is not tax deductible to the seller because the payment is compulsory.

An organization that promotes a tax avoidance scheme is not entitled to exemption as an organization described in section 501(c)(3). See Church of World Peace, Inc. v. Commissioner, T.C. Memo 1994-87 (1994). In its promotional materials ORG advertised that sellers who participate in its DPA program would be able to claim a charitable contribution deduction for their payments to ORG. ORG used the prospect of a charitable contribution deduction as an inducement for sellers to participate in its DPA program. In claiming that the seller-participants in its DPA program would be entitled to a charitable contribution deduction, ORG misrepresented the quid pro quo nature of these payments. Because ORG has promoted

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improper charitable contribution deductions in connection with its DPA program, ORG does not operate exclusively for exempt purposes enumerated in section 501(c)(3) and does not qualify for exemption as an organization described in section 501(c)(3).

Based on the foregoing, ORG has not operated exclusively for exempt purposes, and, accordingly, is not entitled to exemption under section 501(c)(3).

The government proposes revoking ORG's exemption effective October 1, 20XX, because the organization operated in a manner materially different from that represented in its application for exemption. In its application for exemption on December 3, 20XX, ORG represented its objectives as follows: "[T]he Project has developed a program to make funds for down payments available to qualified participants, which shall primarily include low-income and very low-income individuals," and "The Project will cause its activities to comply with the Internal Revenue Service Revenue Procedure 96-32, and the Project has signed a Declaration of Compliance with Revenue Procedure 96-32 which is attached hereto." Despite these representations in its application for exemption, ORG does not have any income limitations for its DPA program and did not screen applicants for down payment assistance based on income. The records provided by ORG did not include data on the buyers' incomes and gave no indication that ORG screened on such data. Rather, ORG's DPA program provided "gifts" to any homebuyers who qualified for a loan. Revocation of a determination letter may be retroactive if the organization operated in a manner materially different from that originally represented. Treas. Reg. § 601.201(n)(6)(i), § 14.01; Rev. Proc. 2003-4, § 14.01. ORG's operation of its DPA activities in a manner materially different from that represented in its application for exemption justifies retroactive revocation of ORG's determination letter.

Conclusion:

In order to qualify for exemption under section 501(c)(3) an organization must be both organized and operated to achieve a purpose that is described under that Code section. ORG's DPA program is not operated in accordance with section 501(c)(3) and the regulations thereunder governing qualification for tax exemption under the Code. ORG provides down payment assistance, purportedly in the form of a gift, to individuals and families for the purchase of a home. ORG offers its down payment assistance to interested buyers regardless of the buyers' income levels or need. ORG's DPA activities do not target neighborhoods in need of rehabilitations or provide other relief such as lessening neighborhood tensions or eliminating prejudice and discrimination.

ORG operates in a manner indistinguishable from a commercial enterprise. ORG's primary activity is brokering transactions to facilitate the selling of homes. ORG's primary goal is to maximize the fees from these transactions. ORG's brokering services are marketed to homebuyers, sellers, realtors, lenders, home builders, and title companies regardless of the buyers' income level or need and regardless of the condition of the community in which the home is located. Alliances are built with the realtors, lenders, home builders, and title companies

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to assure future business for the mutual benefit of the participants. ORG does not engage in any other activities that further charitable purposes. Because ORG's primary activity is not conducted in a manner designed to further section 501(c)(3) purposes, ORG is not operated exclusively for exempt purposes within the meaning of section 501(c)(3).

Further, ORG has promoted tax avoidance in connection with its DPA program by advising sellers that they may take a charitable contribution deduction for their payments to ORG even though such payments were quid-pro-quo payments for services rather than payments motivated by detached and disinterested generosity. ORG's promoter activities are inconsistent with section 501(c)(3) exemption.

For the foregoing reasons, revocation of exempt status is proposed. Because the facts show that, in fiscal year 20XX, ORG operated in a manner materially different from that represented in its Form 1023 application, the government proposes that the revocation be effective October 1, 20XX.

Organization's Position:

Report was discussed with ORG's President, President, on 10/22/20XX during closing conference. Although the organization does not welcome revocation of its exempt status, they are in agreement that the manner in which they operated and their sole reliance upon funding from home sellers is prohibited under Section 501(c)(3) of the Code. President indicated verbally that the organization has no plans to appeal the proposed revocation and did not submit a written protest within 30 days as instructed by Letter 3618 issued on 9/21/20XX.

Internal Revenue Service

Department of the Treasury
TE/GE EO Examinations
401 W. Peachtree St., Stop 504-D
Atlanta, GA 30308

Date: **SEP 21 2007**

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination